

Notice of Proposed Regulatory Action

**The State Board of Equalization Proposes to Adopt Amendments to
California Code of Regulations, Title 18,
Section 1655, *Returns, Defects and Replacements***

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1655, *Returns, Defects and Replacements*, which incorporate and implement, interpret, and make specific amendments made to Civil Code sections 1793.2 and 1793.25, by Assembly Bill No. 242 (AB 242) (Stats. 2011, ch. 727). The amendments to these sections require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the use tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to California's "Lemon Law."

The proposed amendments to Regulation 1655, subdivision (b)(2)(A) incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D) by specifying that the term buyer includes a lessee of a new motor vehicle. The proposed amendments to Regulation 1655, subdivisions (b)(2)(B) and (C) add "or use" tax where the current regulation refers to "sales tax or sales tax reimbursement." The proposed amendments to Regulation 1655, subdivision (b)(2)(B) add "or lease" after "sales" where the current regulation refers to "sales agreement" and after "sale" where the current regulation refers to "retail sale." The proposed amendments to Regulation 1655, subdivision (b)(2)(B) add "or lessor" after "dealer" where the current regulation refers to "the buyer and the dealer" and "the seller's permit number of the dealer." The proposed amendments revise and reformat the last sentence in Regulation 1655, subdivision (b)(2)(B) to require a manufacturer, when filing a claim for refund, to include "evidence of one of the following" from a list of proof that: (1) "The dealer had reported and paid sales tax on the gross receipts from that sale"; (2) "The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state"; or (3) "The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of the vehicle." The proposed amendments also add a new subdivision (b)(2)(D) to Regulation 1655 to specify that "The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee," as provided by Civil Code section 1793.25, subdivision (e).

PUBLIC HEARING

The Board will conduct a meeting in Room 121, at 450 N Street, Sacramento, California, on April 22-24, 2014. The Board will provide notice of the meeting to any person who

requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board's Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 10:00 a.m. or as soon thereafter as the matter may be heard on April 22, 2014. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1655.

AUTHORITY

RTC section 7051

REFERENCE

RTC sections 6006-6012, and 6012.3; Civil Code sections 1793.2-1793.25; Vehicle Code sections 11713.12 and 11713.21

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

General

The Song-Beverly Consumer Warranty Act (commencing with Civ. Code, § 1790) contains provisions that provide warranty protections to purchasers of both new and used consumer goods. The act includes provisions (Civ. Code §§ 1793.2 - 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California's "Lemon Law." The Lemon Law provides, in relevant part, that if a manufacturer or its representative in this state, such as an authorized dealer, is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer is required to either promptly replace the vehicle or make restitution to the buyer. (Civ. Code, § 1793.2, subd. (d)(2).)

Under the existing Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant here, a "sale" and a "purchase." (Rev. & Tax. Code, §§ 6006, 6010.) For a lease that is a "sale" and a "purchase," the tax is measured by the rentals payable. However, as provided in subdivision (c)(1) of Regulation 1660, *Leases of Tangible Personal Property – In General*, the applicable tax is generally use tax, not sales tax, and the lessor is required to collect the use tax from the lessee at the time the amount of rent is paid and give him or her a receipt as prescribed in Regulation 1686, *Receipts for Tax Paid to Retailers*. The lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

The Lemon Law originally provided that in the case of restitution, a manufacturer was required to make restitution in an amount equal to the actual price paid or payable by the buyer, including, among other collateral charges, *sales* tax. (Civ. Code, § 1793.2.) The Lemon Law further required the Board to reimburse the manufacturer for an amount equal to the *sales* tax which the manufacturer paid to or for a buyer when providing a replacement vehicle or included in making restitution to the buyer when satisfactory proof was provided that the retailer of the motor vehicle for which the manufacturer was making restitution had reported and paid the sales tax on the gross receipts from the sale, and that the manufacturer had complied with the requirements of Civil Code section 1793.23, subdivision (c). However, the Lemon Law was silent with respect to whether restitution was required to include *use* tax and whether the Board was required to reimburse a manufacturer for use tax paid to or for a buyer or lessee or included in restitution paid to a buyer or lessee.

As relevant here, AB 242 amended the Lemon Law, specifically Civil Code sections 1793.2 and 1793.25, to make technical corrections sponsored by the Board. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to the Lemon Law. And, AB 242 provides that the Board-sponsored amendments to the Lemon Law are declaratory of existing law. (AB 242, § 21.)

In the case of restitution, Civil Code section 1793.2, subdivision (d)(2)(B) now provides, in relevant part, that the manufacturer shall make restitution in an amount equal to the actual price paid or payable by the buyer, including any collateral charges “such as sales or use tax.” And, Civil Code section 1793.2, subdivision (d)(2)(D) now specifies that “Pursuant to Section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

With respect to reimbursement, Civil Code section 1793.25, subdivision (a) now expressly requires the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to “the sales tax or use tax” which the manufacturer pays to or for the buyer “or lessee” when providing a replacement vehicle or includes in making restitution to the buyer “or lessee” under the Lemon Law, and, as a condition to receiving reimbursement, requires a manufacturer to provide satisfactory proof for one of the following:

- The retailer of the motor vehicle for which the manufacturer is making restitution has reported and paid the sales tax on the gross receipts from the sale of that motor vehicle.
- The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state.
- The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of that motor vehicle.

Also, Civil Code section 1793.25, subdivision (e) now provides that “The amount of use tax that the State Board of Equalization is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee” under the Lemon Law.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1655

Need for Clarification

Subdivision (b)(2) of Regulation 1655 explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement included in restitution paid to a buyer under the Lemon Law. However, Regulation 1655 does not indicate that AB 242 clarified that, under the Lemon Law, restitution includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle and required the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or includes in making restitution to a buyer or lessee, under the Lemon Law. Therefore, the Board’s Business Taxes Committee (BTC) staff determined that amendments to Regulation 1655 are needed in order to make the regulation consistent with and implement, interpret, and make specific AB 242’s amendments to the Lemon Law set forth above.

Interested Parties Process

As a result of AB 242, BTC staff drafted amendments to Regulation 1655. Specifically, the draft amendments suggested adding language to Regulation 1655, subdivision (b)(2)(A) to incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D), by specifying that, for purposes of Regulation 1655, the term buyer includes a lessee of a new motor vehicle. The draft amendments suggested adding “or use” tax to where the current regulation refers to “sales tax or sales tax reimbursement” in subdivision (b)(2)(B) and (C). The draft amendments suggested adding “or lease” after “sales” where the current regulation refers to “sales agreement” and after “sale” where the current regulation refers to “retail sale” in subdivision (b)(2)(B). The draft amendments also suggested adding “or lessor” after “dealer” where the current regulation refers to “the buyer and the dealer” and “the seller’s permit number of the dealer” in subdivision (b)(2)(B).

In addition, the draft amendments suggested revising and reformatting the last sentence in Regulation 1655, subdivision (b)(2)(B), which currently requires a manufacturer, when filing a claim for refund for sales tax or sales tax reimbursement included in restitution paid to a buyer, to submit evidence that the dealer who made the retail sale of the non-conforming vehicle to that buyer reported and paid sales tax on the gross receipts from that sale. The revised and reformatted sentence requires a manufacturer, when filing a claim for refund for sales or use tax or sales tax reimbursement included in restitution

paid to a buyer, including a lessee, under the Lemon Law, to provide “evidence of one of the following” from a list that includes proof that: (1) “The dealer had reported and paid sales tax on the gross receipts from that sale”; (2) “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of the vehicle.” The draft amendments also suggested adding a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

BTC staff subsequently prepared a discussion paper regarding the amendments made to the Lemon Law by AB 242 and staff’s draft amendments to Regulation 1655, provided the discussion paper and its draft amendments to Regulation 1655 to the interested parties, and conducted an interested parties meeting on August 8, 2013, to discuss the draft amendments to Regulation 1655. During the interested parties meeting, a participant inquired as to how the provisions of Regulation 1655 would apply to a transaction in which a lessor paid tax at the time the lessor purchased a vehicle which the lessor would then lease. Staff considered the scenario and, subsequent to the meeting, staff explained to the participant that in the event a lessor purchases a vehicle in this state tax paid, the transaction would generally be subject to sales tax and the dealer would likely collect sales tax reimbursement from the lessor. (See Reg. 1660, subd. (c)(2) and (3), regarding property purchased tax-paid and leased in substantially the same form as acquired.) And, staff explained that, with respect to sales tax transactions, the existing provisions of Regulation 1655 would apply to a manufacturer’s claim for a refund for sales tax reimbursement the manufacturer included in restitution paid to a lessor, under the Lemon Law. Furthermore, staff noted that AB 242 did not change the application of the Lemon Law to sales tax transactions, and that questions regarding the application of Regulation 1655 to sales tax transactions were beyond the scope of the current interested parties process, which was to discuss the issue of whether to amend Regulation 1655 to clarify the new provisions of the Lemon Law applicable to use tax transactions.

Since BTC staff did not receive any other inquiries or comments regarding its draft amendments during or subsequent to the first interested parties meeting and staff had no changes to its recommendation to amend Regulation 1655, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff’s draft amendments. Staff also notified interested parties that comments could be submitted up to October 17, 2013, for consideration in the preparation of a Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

December 17, 2013, BTC Meeting

Subsequently, staff prepared Formal Issue Paper 13-012 and distributed it to the Board Members for consideration at the Board’s December 17, 2013, BTC meeting. Formal Issue Paper 13-012 recommended that the Board approve and authorize publication of the

amendments to Regulation 1655 (discussed above) in order to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle (as provided in Civ. Code, § 1793.2, subd. (d)(2)(D), as added by AB 242).
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund (consistent with Civ. Code, § 1793.25, subd. (a), as amended by AB 242).
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee (as provided in Civ. Code, § 1793.25, subd. (e), as added by AB 242).

During the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1655 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1655 are reasonably necessary to have the effect and accomplish the objective of making the regulation consistent with and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1655 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1655 is the only state regulation prescribing the requirements for the Board to reimburse a manufacturer under Civil Code section 1793.25. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1655 or the proposed amendments to Regulation 1655.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1655 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1655 will result in no direct or indirect cost or savings to any state agency, cost to any local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1655 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1655 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1655 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1655 will not affect the benefits of Regulation 1655 to the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

The adoption of the proposed amendments to Regulation 1655 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out

the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Monica Gonzalez Silva, Tax Counsel III, by telephone at (916) 323-3138, by e-mail at Monica.Silva@boe.ca.gov, or by mail at State Board of Equalization, Attn: Monica Gonzalez Silva, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 10:00 a.m. on April 22, 2014, or as soon thereafter as the Board begins the public hearing regarding the adoption of the proposed amendments to Regulation 1655 during the April 22-24, 2014, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1655. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1655 illustrating the express terms of the proposed amendments. The Board has also prepared an initial statement of reasons for the adoption of the proposed amendments to Regulation 1655, which includes the economic impact assessment required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1655 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the original proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1655, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.